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No. 80-299

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

JOHN NUVEEN & CO., INC., a corporation, INVESTORS SYNDICATE OF AMERICA, INC., a corporation, and INVESTORS DIVERSIFIED SERVICES, INC., a corporation

Petitioners,

v.

HENRY T. SANDERS, et al.,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

	PAGE
I. THE BRIEF OF THE SOLICITOR GENERAL IGNORES THE PRIOR BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN THIS CASE IN WHICH THE COMMISSION URGED CLARIFICATION OF THE RELATIONSHIP BETWEEN SECTIONS 11 AND 12(2) AND CONCLUDED THAT NUVEEN HAD ACTED WITH "REASONABLE CARE" ASSUMING THAT THE COMMERCIAL PAPER WAS NOT REQUIRED TO BE REGISTERED	2
II. THE SOLICITOR GENERAL ACKNOWLEDGES THAT QUESTION NO. 3 IN THE PETITION IS SUBSTANTIAL	5
III. THE PETITION PRESENTS SUBSTANTIAL QUESTIONS OF LAW AND DOES NOT SEEK REVIEW OF FINDINGS OF FACT	5
CONCLUSION	7

TABLE OF AUTHORITIES

Cases

Chiarella v. United States, 100 S.Ct. 1108 (1980)	5
Lorber v. Beebe, 407 F.Supp. 279 (S.D.N.Y. 1976)	5
Mallinckrodt Chemical Works v. Goldman, Sachs & Co., 420 F.Supp. 231 (S.D.N.Y. 1976)	6
Pharo v. Smith, 621 F.2d 656 (5th Cir. 1980), reh. granted on other grounds, 625 F.2d 1226 (5th Cir. 1980)	3
Securities and Exchange Commission v. Sloan, 436 U.S. 103 (1978)	5
Touche Ross & Co. v. Redington, 442 U.S. 560 (1979)	5

Statutes

PAGE

Securities Act of 1933:

Section 2(11), 15 U.S.C. § 77b(11) 3

Section 11, 15 U.S.C. § 77k 2, 3, 4

Section 11(b)(3), 15 U.S.C. § 77k(b)(3) 3

Section 12(2), 15 U.S.C. § 77*l*(2) 2, 3, 4

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The respondents have filed a brief in opposition to the petition and, at the invitation of the Court, the Solicitor General has filed a brief for the United States as amicus curiae ("S.G.Br.").* Only a few points in these briefs merit response at this time.

* Other abbreviations used herein are the same as those used in the Petition. In compliance with Supreme Court Rule 28.1, as amended, petitioners hereby advise the Court that The St. Paul Companies, Inc. is the parent corporation of petitioner Nuveen and

(footnote continued)

I.

THE BRIEF OF THE SOLICITOR GENERAL IGNORES THE PRIOR BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION IN THIS CASE IN WHICH THE COMMISSION URGED CLARIFICATION OF THE RELATIONSHIP BETWEEN SECTIONS 11 AND 12(2) AND CONCLUDED THAT NUVEEN HAD ACTED WITH "REASONABLE CARE" ASSUMING THAT THE COMMERCIAL PAPER WAS NOT REQUIRED TO BE REGISTERED

The Solicitor General's position that "this case is not an appropriate vehicle for clarifying the relationship between Sections 11 and 12(2)" of the 1933 Act (S.G.Br. 7) is impossible to reconcile with the previous views of the SEC. On its own initiative the SEC filed a brief as amicus curiae in *Sanders III* (hereinafter referred to as its "prior brief") seeking, among other things, clarification of the relationship between those statutory provisions. The SEC thought the issues were significant then; they are no less significant now.

The Solicitor General's brief conspicuously omits discussion of positions taken by the SEC in its prior brief, positions which in significant respects are at odds with those now advanced by the Solicitor General. In its prior brief the SEC contended that in an action under Section 12(2) of the 1933 Act involving commercial paper which was not required to be registered, it was inappropriate to impose upon the seller the burdens imposed by Section

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that associated funds of petitioner IDS are Investors Mutual Inc., Investors Selective Fund, Inc., Investors Stock Fund, Inc., Investors Variable Payment Fund, Inc., IDS New Dimensions Fund, Inc., IDS Progressive Fund, Inc., IDS Growth Fund, Inc., IDS Bond Fund, Inc., IDS Cash Management Fund Inc. and IDS Tax-Exempt Bond Fund Inc.

11(b)(3) of the 1933 Act.* (SEC Br. 60-61, 69, 74) Notwithstanding the facts stated in the Solicitor General's brief (S.G.Br. 4), it was the SEC's view that if the commercial paper was not required to be registered, Nuveen met its obligation of reasonable care. (SEC Br. 61, 76) In *Sanders III*, after the SEC's amicus presentation, the Court of Appeals expressed "great doubt" that registration was required here. (A. 52) Therefore, the holding in *Sanders IV* that in these circumstances the exercise of "reasonable care" required discharge of the due diligence burdens imposed by Section 11 (A. 13) is inconsistent with the views expressed by the SEC.

Notwithstanding the statement of the Solicitor General to the contrary (S.G.Br. 8), the Court of Appeals explicitly held that in this case "the reasonable care standard [under Section 12(2)] required the reasonable investigation described in *Sanders II* [*i.e.*, in accordance with Section 11]." (*Sanders IV*, A. 13 footnote omitted) Thus, an important issue clearly presented by the Petition is whether such a convergence of the standards is ever appropriate and, if so, when. (*See* Question No. 1)

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* The Solicitor General and respondents repeatedly describe Nuveen as an underwriter. Petitioners have demonstrated, however, that Nuveen's status as an "underwriter", as that term is defined in Section 2(11) of the 1933 Act, does not determine the parameters of its liabilities. (Pet. 9-11) *See also Pharo* v. *Smith*, 621 F.2d 656, 671 (5th Cir. 1980), *reh. granted on other grounds*, 625 F.2d 1226 (5th Cir. 1980):

> Plaintiff also seeks to impose liability on Deltec as an underwriter, citing section 2(11) [of the 1933 Act]. Section 2(11) defines an underwriter, but it does not define unlawful conduct or create any liability for a person who is an underwriter. Accordingly, plaintiffs must predicate Deltec's liability on another provision of the [1933 Act].

In its prior brief the SEC took issue with the statement by the Court of Appeals in *Sanders II* that in certain circumstances a seller should review accountants' work papers. (*Sanders II*, A. 69; SEC Br. 68) Now the Solicitor General merely, and incorrectly, characterizes this troublesome ruling as, at most, an alternative holding. (S.G.Br. 8). The Solicitor General ignores the fact that the court below held that Nuveen had failed to exercise reasonable care because it had not "determin[ed] the basic integrity of the issuer's financial statements." (*Sanders II*, A. 72, followed in *Sanders IV*, A. 10-13) This language unmistakably imposed a burden upon the seller to take affirmative steps to verify the accuracy of certified financial statements, a burden which is manifestly not imposed by Section 11. (Pet. 12-14) The Petition thus squarely presents the further important question whether it is ever appropriate to impose greater burdens in an action under Section 12(2) than would be imposed under Section 11. (*See* Question No. 2)

Accordingly, the SEC was correct in contending in its prior brief that this case presents important issues. The Solicitor General has failed to address the fact that in large measure the SEC previously supported the petitioners and that the ruling below is inconsistent with the views expressed by the SEC.

Finally, the Solicitor General has *not* indicated agreement with the ruling below. The brief states merely that in the circumstances here presented "a standard of care that is the same or similar to that imposed by Section 11 *may* be appropriate" and "the standard of 'reasonable care' under Section 12(2) *may* converge with the standard of 'reasonable investigation' prescribed under Section 11". (S.G.Br. 7-8) (emphasis added) Where the questions presented are important and the ruling below may be in error, review should be granted by this Court.

II.

THE SOLICITOR GENERAL ACKNOWLEDGES THAT QUESTION NO. 3 IN THE PETITION IS SUBSTANTIAL

The Solicitor General acknowledges that the causation issue presented by Question No. 3 of the Petition (Question No. 2 as framed by the Solicitor General) is "not insubstantial". (S.G.Br. 9) The Solicitor General does *not* express agreement with the ruling below on this issue, which is not only "not insubstantial" as a legal matter but is important in the administration of the law. The Solicitor General merely suggests an absence of conflicting decisions. (S.G.Br. 10) (*But see Lorber* v. *Beebe*, 407 F.Supp. 279 (S.D.N.Y. 1976) (Pet. 24)) However, in recent years this Court has granted certiorari to decide important questions arising under the federal securities laws even though the case was one of first impression at the appellate level. *See Chiarella* v. *United States*, 100 S.Ct. 1108 (1980); *Touche Ross & Co.* v. *Redington*, 442 U.S. 560, 577 n. 19 (1979); *Securities and Exchange Commission* v. *Sloan*, 436 U.S. 103 (1978).

III.

THE PETITION PRESENTS SUBSTANTIAL QUESTIONS OF LAW AND DOES NOT SEEK REVIEW OF FINDINGS OF FACT

The Solicitor General seeks to portray this case as one that would require resolution of issues of fact by this Court, referring, for example, to "conflicting evidence." (S.G.Br. 3) On the contrary, one of the reasons that this case is particularly suited for review by this Court is that there was remarkably little conflicting evidence. The principal issues presented to the courts below related to the proper interpretation of provisions of the 1933 Act and

the application of those provisions to the largely undisputed facts.*

* There are, however, several misconceptions of fact in the brief of the Solicitor General. While it is true that Winter & Hirsch commercial paper was never rated "prime" by the National Credit Office (S.G.Br. 7), the difference between the "prime" and "desirable" ratings of that service was *solely* one of the size of the issuer, not its creditworthiness in a qualitative sense. *Mallinckrodt Chemical Works* v. *Goldman, Sachs & Co.*, 420 F.Supp. 231, 233 n. 3 (S.D.N.Y. 1976).

The statement that Nuveen "sold the notes on the basis 'that there should be no question but what the paper will be paid at maturity' " (S.G.Br. 1) was neither a guarantee by Nuveen nor a statement made to any plaintiff. It was a statement made by the head of Nuveen's commercial paper department *to the president of Winter & Hirsch* by way of explanation that Nuveen strove for that goal in choosing issuers of commercial paper and, therefore, was *terminating* its selling of Winter & Hirsch commercial paper upon learning of the rumors about its financial condition. (Trial Transcript 339)

The statement in Nuveen's commercial paper reports that the financial information contained therein was obtained from a "detailed audit" did not misrepresent any facts. (S.G.Br. 4, 6) A long form audit report with extensive schedules, such as the Lieber, Bleiweis reports on Winter & Hirsch, is called a "detailed audit report," even though it is not the result of a detailed audit of all transactions of the company. (Trial Transcript 275)

CONCLUSION

The Solicitor General's brief concludes with a lengthy footnote suggesting that, irrespective of the correctness *vel non* of the ruling below, this case should be ended and plaintiffs should be allowed to collect the judgment. (S.G.Br. 10 n. 11) This suggestion is extraordinary, particularly in light of the fact that the Solicitor General has neither expressed concurrence with the rulings below nor taken a position on the issues not resolved below. Moreover, on August 14, 1980, petitioners paid the full amount of the judgment to the Clerk of the District Court. Petitioners therefore have nothing to gain merely by protracting these proceedings, as intimated by the Solicitor General. Rather, petitioners seek an application of the federal securities laws consistent with the language of the statute and with recent decisions of this Court.

The SEC—the federal agency charged with the administration of the federal securities laws—has previously urged that the questions presented regarding the standard of care (Questions Nos. 1 and 2) do require clarification. The Solicitor General acknowledges that Question No. 3 is substantial. The Solicitor General does not contend that the case was correctly decided. For the reasons given herein and in the Petition for Certiorari, petitioners pray that the writ be granted.

Respectfully submitted,

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